Office of Chief Counsel
Internal Revenue Service
memorandum

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to: Andrew Zuckerman
Director, EP Rulings and Agreements SE:T:EP:RA

from: Michael J. Roach Michael J. Roach
Branch Chief, Qualified Plans Branch 1 (Employee Benefits)
(Tax Exempt & Government Entities)

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subject: [redacted]
Investment in the Contract for UN Pension

This is response to your memorandum dated March 7, 2007, requesting our assistance regarding the taxable amount of payments to [redacted] from the pension plan maintained by the United Nations. [redacted] has asked what portion of his pension payments would be taxable in the United States if he were to become a U.S. resident, to determine the treatment of his pension payments under the United States-Canada Income Tax Treaty. You have asked us whether [redacted] employee contributions to that pension plan are included in [redacted] investment in the contract taking into account the rules of §§ 72(f) and 72(w).

Facts

[redacted] has been a Canadian citizen during all relevant time periods and was a nonresident alien during his employment with the [redacted] (which is an organ of the United Nations based in [redacted]). His services were performed outside the United States and, for short periods, at the United Nations headquarters in New York.

[redacted] participated in the United Nations Joint Staff Pension Fund (the Plan) from [redacted] through [redacted], and made $[redacted] in employee contributions to the Plan during that time. The employer contributed twice that amount to the Plan on [redacted] behalf. Neither employee contributions nor employer contributions were taxable by Canada at the time contributions were made. At the time of his retirement in [redacted], he received a portion of his benefit under the Plan as a single sum. He is currently receiving the remainder of his benefit under the Plan as a joint and survivor annuity. The Plan received a favorable determination letter from the Service regarding its qualified status on [redacted], and there is no indication that the Service has not continued to treat the plan as a qualified plan.

Under Article XVIII of the United States-Canada Income Tax Treaty, Canada may tax its residents on pension payments arising in the United States only to the extent those payments would be included in U.S. income if they had been received by a resident of the United States. Accordingly, [redacted] has asked what portion of his pension payments would be taxable in the United States if he were to become a U.S. resident.

Law and Analysis

Section 72(a) provides generally that gross income includes any amount received as an annuity under an annuity contract. Under section 72(b)(1), gross income does not include that part of any amount received as an annuity under an annuity contract which bears the same ratio to such amount as the investment in the contract (as of the annuity starting date) bears to the expected return under the contract (as of such date). Section 72(d) specifies the method to be used to recover a participant's investment in the contract with respect to payments under a qualified retirement plan.

Section 72(c) defines the investment in the contract as of the annuity starting date as the aggregate amount of premiums or other consideration paid for the contract over the aggregate amount received under the contract before that date, to the extent that the aggregate amount received under the contract before that date was excludable from gross income.

Section 72(f) provides that, in computing the aggregate amount of premiums or other consideration paid for the contract for purposes of determining investment in the contract, the aggregate premiums or other consideration paid, amounts contributed by the employer are included, but only to the extent that such amounts were includible in the gross income of the employee, or if such amounts had been paid directly to the employee at the time they were contributed, they would not have been includible in the gross income of the employee under the law applicable at the time of the contribution (subject to an exception that is not relevant here).

Section 72(w) provides that, notwithstanding any other provision of § 72, for purposes of determining the portion of any distribution that is includible in gross income of a distributee who is a citizen or resident of the United States, the investment in the contract does not include any applicable nontaxable contributions or applicable nontaxable earnings. For this purpose, the term "applicable nontaxable contributions" means any employer or employee contribution which was made with respect to services performed by an employee who, at the time the services were performed, was a nonresident alien, and which is treated as from sources without the United States, and which was not subject to income tax (and would have been subject to income tax if paid as cash compensation) under the laws of the United States or any foreign country. The term "applicable nontaxable earnings" means earnings that are paid or accrued with respect to any employer or employee contribution that was made with respect to compensation for services performed by an employee, with respect to which the employee was at the time the earnings were paid or accrued a nonresident alien, and

which were not subject to income tax under the laws of the United States or any foreign country.

The employee contributions paid by [redacted] constitute investment in the contract pursuant to § 72(c) because they were paid by him and are not excluded from investment in the contract by any provision (§ 72(w) does not apply to [redacted] because he is not a U.S. citizen or resident). Pursuant to § 872 (which generally excludes from gross income foreign-earned compensation of nonresident aliens) and § 893 (which generally excludes from gross income compensation of nonresident alien employees of international organizations), employer contributions to the Plan with respect to [redacted] benefit would not have been included in [redacted] gross income if received in cash at the time the contributions were made. Accordingly, employer contributions with respect to [redacted] benefit are also investment in the contract under the rules of § 72(f).

If [redacted] were to become a U.S. resident, then the rules of § 72(w) would begin to apply to [redacted] Under those rules, the investment in the contract would not include any applicable nontaxable contributions. Applicable nontaxable contributions would include any employer or employee contribution that was made with respect to services performed by [redacted] and that were not subject to income tax (and would have been subject to income tax if paid as cash compensation) under the laws of the United States or any foreign country. There is information in the file that indicates that United Nations salary payments are not included in Canadian taxable income. If this is the case (so that employer and employee contributions would not have been taxed by any country if they had instead been paid in cash to [redacted] at the time), then the rules of § 72(w) would not exclude those contributions from investment in the contract if [redacted] were to become a U.S. resident.